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C O N F I D E N T I A L SECTION 01 OF 03 AMMAN 002295

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TAGS: ECON EAID EFIN KPRV EPET PGOV JO
SUBJECT: ECONOMIC REFORM PROGRAM ON TRACK

REF: A. 2004 AMMAN 9311
¶B. 2004 AMMAN 6441
¶C. 2004 AMMAN 4330

Classified By: CDA Christopher Henzel for reason 1.4 (b) and (d)

¶1. (C) SUMMARY: While Jordan remains dependent on foreign aid, its economic reform program is making substantial progress that has continued, undiminished in scope and urgency, since its "graduation" from an IMF program in summer ¶2004. The GOJ has succeeded in limiting the growth of current expenditures over the past year, has posted a significant increase in domestic government revenues through improvements in its collection of taxes, has reacted to sustained, higher-than-expected world crude prices by reaffirming its plan to implement a phased elimination of all fuel subsidies, and plans to conduct one of its most significant waves of privatization to date over the upcoming 18 months. Despite increased political pressures to use Jordan's recent economic growth to increase GOJ transfer payments to the traditional pillars of support for the King and the GOJ, all signs are that the GOJ remains committed to reform. END SUMMARY.

¶2. (C) Jordan received over $1 billion in aid in 2004; the total size of its recorded economy was $10.9 billion. Since the mid-1970s, foreign aid has been the second-largest source of foreign exchange, after remittances. Before this, foreign aid was the number one source of foreign exchange. Notwithstanding this historical pattern of dependence upon foreign assistance and the large role aid still plays in the Jordanian economy, both King Abdullah and the GOJ understand the lessons of Jordan's economic collapse of 1989 and are exerting significant efforts to put GOJ finances - and Jordan's economy as a whole - on a sustainable basis that would assure its health even in the absence of foreign grants. Jordan's Finance Minister Abu Hammour has repeatedly stressed to us the importance of building on IMF-spurred economic reforms, and the GOJ's actions have matched his words. Since the beginning of 2004, the GOJ has taken action to improve GOJ finances through several measures, many of which have been put in place since the end of the IMF program in 2004.

CURRENT EXPENDITURES

¶3. (C) At the urging of the USG and IMF, Jordan in 2005 for the first time has implemented measures that improve the transparency of its budget, by including previously off-budget revenue and expenditures as line items on the budget. In the long term, this change will make it more difficult for the GOJ to hide subsidies and will therefore create domestic pressure for their elimination; in the short run, it makes the GOJ's balance sheet look worse. For example, Jordan's large fuel subsidies were included on the budget for the first time in 2005. Their inclusion adds a substantial liability to the balance sheet and has provoked substantial Parliamentary debate.

¶4. (C) In its 2005 budget, Jordan's largest sources of current expenditures are the fuel subsidies ($437.2 million), whose phased elimination is currently scheduled to conclude by the end of 2007 (see below), interest on Jordan's debt ($486 million), salaries of government employees (approximately $686.3 million), and pensions ($584.2 million). Jordan has made significant progress in reducing its debt payments by paying off some of its high-interest debt early and replacing it with lower-interest domestically-held debt; it has also paid some debt outright and received debt forgiveness as a form of aid. Pensions, by their nature, are more difficult to cut; nonetheless, Finance Minister Abu Hammour has been able to achieve successes in limiting the growth of this liability for the GOJ. At the beginning of 2004, Abu Hammour was able to push through a reduction in the size of the pension of new military retirees, a significant government constituency (ref A). Also from the beginning of 2004, all incoming government employees have been transferred to the Social Security Corporation (SSC) for their pensions (ref B), a step which adds costs to the GOJ in the short term - as it has to pay in to the SSC immediately - but will deduct costs from the GOJ in the long run, as the SSC will be responsible for paying out the pensions instead of the GOJ. Increases in government salaries in the 2005 budget are held to approximately the

same levels the increases in 2004 and 2003.

TAXATION

¶5. (C) Jordan's General Sales Tax (GST) provides the majority of Jordan's domestic revenues. In a region famous for its high rates of tax evasion, the GST is the most easily collected tax; it is also clearly the most regressive tax, making each rise fall disproportionately upon the poorest in Jordanian society. The GST currently stands at 16% on virtually everything sold in Jordan (although the IMF had originally recommended an increase to 15%, the GOJ had managed to secure the higher figure) and it supplies 42% of revenue; income tax supplies another 11%, customs income contributes 10%, and the balance is supplied by other taxes, fees, institutional revenues, and other miscellaneous income sources. Abu Hammour has committed to improving the collection of existing taxes rather than the imposition of new ones, and he is proud of the success that the tax department has had to date in increasing revenues through improved efficiency in the collection of taxes - he estimates an increase of almost $100 million over 2004 through these improvements alone. To support the Minister's efforts, USAID is planning the launch of a subststantive fiscal reform program targeting the administration of tax revenues, with a planned start date late in 2005.

¶6. (C) Abu Hammour plans to turn his attention to the Customs Directorate in 2005, with USAID support. He envisions making substantial - if slightly smaller - returns. There is substantial scope for improvement in customs receipts since, as Abu Hammour puts it, "70% of the Directorate staff is corrupt." This move is likely to provoke substantial resistance, as opportunities for corruption have made the jobs highly sought after by people with influence. Nonetheless, Abu Hammour plans to press on with his reforms in this sector, and he appears to have royal support in this enterprise.

FUEL SUBSIDY

¶7. (C) Constantly rising crude prices - along with rising consumption - have given Jordan a moving target as it has tried to eliminate its fuel subsidies. Jordan's initial target of a three-year phased rise in the prices it set for oil derivatives (including petroleum, diesel, fuel oil, kerosene, etc.) was based on the assumption - at the time considered conservative - that crude prices would hover at between $35-40 per barrel at the end of the three-year period. As Jordan entered the latter half of 2004 (the second of the three years) with the global price of crude near $50, it became clear that in order to erase the differential between the price of Jordan's subsidized oil derivatives and their natural cost given the high world price of crude, Jordan would need to increase fuel prices in 2005 by a greater amount than the increases of 2003 and 2004 combined - and this from a base price already at a historically high level. The GOJ therefore took the decision to extend its schedule of fuel price increases for an additional two years. The IMF had suggested that this extension might be necessary when we had met with them in June (ref C); we heard no complaint about this policy when we met in October with Martin Petri, an IMF senior economist who collaborated with Jordan during its "workout" program and who has visited periodically at Minister Abu Hammour's request in order to check up on Jordan's progress since its "graduation."

¶8. (C) The GOJ currently predicts that in absolute terms, its fuel product price increase will be slightly greater in 2005 than in 2004 and 2003; it plans similarly-sized price hikes in 2006 and 2007. The GOJ will, however, stop making large annual increases and shift to smaller quarterly increases, in hopes of limiting popular reaction.

PRIVATIZATION

¶9. (C) Due to foreign investors' lack of interest in Jordanian assets in the period leading up to and immediately following the March-April 2003 regime change in Iraq, most of Jordan's privatization program was put on ice. Now, however, the ramping-up of several previously shelved privatizations that began in late 2003 has reached its culmination, and Jordan's Executive Privatization Commission - supported by the USAID privatization program - has a full plate for 2005-6. Jordan's Ministry of Energy has launched a strategic plan envisioning the privatization of almost the entirety of Jordan's power sector (septel). The MOE has already issued a request for proposals (RFP) from interested parties for the sale of the GOJ's 100% stake in CEGCO, Jordan's power-generation company; in the future, either the

privatized CEGCO will build power plants or other private corporations will do so under build-operate-transfer (BOT) contracts. In addition, the government is moving to sell its stakes in two regional power-distribution companies by the end of the year. Once these sales are completed, the GOJ will only retain the country's power-transmission backbone. Similarly, Jordan's Civil Aviation Authority has taken on a consultant to prepare it for the privatization of its remaining non-core functions. The GOJ has also announced its intent to sell off its remaining shares of Jordan Telecom later this year; privatization of the postal service is to follow in 2006.

¶10. (C) In its pursuit of full privatization of government assets, Jordan has shown a surprisingly strong willingness to challenge politically important constituencies. Planned for September of 2005, for example, is an RFP for a strategic partner to take 40% of GOJ's stake (and a management contract) in the perennially money-losing Jordan Phosphate Mining Corporation (JPMC), the largest single employer by far in Ma'an Province, an area of southern Jordan known for its Islamist leanings. The JPMC privatization plan is scheduled to go forward despite the repeatedly expressed objections of parliamentarians to the sale of any part of the company. Virtually the only major corporation in which the GOJ plans to retain ownership by mid-2006 will be Royal Jordanian Airlines (RJ), and the RJ CEO has noted to us his belief that RJ will hold an IPO in late 2006 - before the promulgation of an Open Skies policy throughout Jordan.

COMMENT

¶11. (C) Nine months after the end of its IMF program, the GOJ's economic reform program remains on track. Despite pressures from several directions to relax its fiscal discipline, the Ministry of Finance has kept a tight rein on the expansion of the government; royal backing and internally-imposed limits such as the Public Debt Law (which calls for debt to be reduced to 60% of GDP by the end of 2006) have ensured that the Ministry has held the line, and the GOJ is putting in place measures that will help to further restrain spending growth. Improvement in domestic revenue collection and phased elimination of fuel subsidies will continue at the same pace in 2005 as in previous years. At the same time, a massive sell-off of GOJ assets and of GOJ stakes in a variety of companies both underlines the commitment of the GOJ to the economic reform agenda proposed by the IMF and holds out the promise of further reductions in current expenditures - both through the debt that will be retired through sale of Jordanian assets and the divestiture of enterprises that run deficits which the GOJ has been forced in the past to cover.
HENZEL